

FISCAL DECENTRALIZATION IN VIETNAM: EMERGING ISSUES

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Abstract

Transition to market economy in Vietnam calls for accommodating changes in policies and institutions for providing public services. The paper traces the evolution of fiscal arrangements, analyzes recent developments and identifies emerging challenges.

Despite recent changes, the issues of incentives, accountability, autonomy and flexibility in decentralized provision of public services are yet to be addressed satisfactorily. The implementation of the new budget law provides a legal framework. It also clarifies the roles of different agencies and levels of government. The stability in arrangements is expected to bring a measure of certainty. On the flip side, the budget determination process is predominantly “top-down” and local governments still do not have powers to raise revenues. Further, there are wide variations in the administrative capacity and building capacity poses another challenge. It is also necessary to introduce a simple and transparent formula based system of transfers to offset revenue and cost disabilities.

Key words: Vietnam; Fiscal decentralization; Intergovernmental transfers

JEL classification: H71, H72, H77, O23

I. Introduction

Economic liberalization or *Doi Moi* initiated in Vietnam since 1989 has helped to significantly accelerate growth and reduce poverty. The per capita GDP in the country grew at about 6-7 percent per year during 1990-97 and this resulted in significant improvement in the living standards of the people. Yet, Vietnam is one of the poorest countries in the world with per capita GDP of less than US\$300 [World Bank (1998)]. It still is largely an agrarian

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economy with 80 per cent of 75 million people live in rural areas and about two-thirds are directly dependent on agriculture. Despite sharp decline in poverty since initiating market based reforms, about 35 per cent of population is still poor. Since 1997, due to regional economic crisis economic growth has decelerated from an average rate of 9 per cent per annum during 1995-97 to 4.5 per cent in 1998 and 1999. Even the devaluation of the dong by 18 per cent in 1999 has not helped to arrest decelerating exports and declining foreign direct investment. The natural disasters in the country have accentuated economic damage. Slowing down the reforms in the wake of regional financial crisis has made Vietnam a less attractive foreign investment destination. In addition, infrastructure bottleneck has presented a binding constraint on the economy to generate and sustain high growth rates.

Inability of the government to provide adequate physical infrastructure and accommodating policies and institutions necessary to provide public services according to the diversified requirements of different regions is a major constraint in sustaining a high rate and creating a shared basis of economic growth in Vietnam. Market decentralization implicit in the transition from a planned to a market economy has to be supported by accommodating fiscal, administrative and political decentralization in order to ensure efficient delivery of public services.

While the institutional arrangement in Vietnam, no doubt, has evolved over the years to accommodate changing requirements, it is necessary to examine whether these changes are adequate and if not, identify the constraints and measures needed to improve the system. This paper analyses the prevailing system of fiscal arrangements in Vietnam. In section II, a brief account of the evolution of fiscal decentralization in Vietnam and the salient features of fiscal arrangements is provided. Section III analyzes the trends in fiscal decentralization and its impact on the provision of public services. Equity Implications of the fiscal arrangements are discussed in Section IV. The last section presents concluding remarks.

II. *Evolution of Fiscal Arrangements in Vietnam*

1. **Evolution of Fiscal Arrangements**

The prevailing fiscal arrangement in Vietnam may be characterized as a de-concentrated system. In this, public services are provided within the unitary system in which, centralized state authority is extended to local administration in provinces, districts and communes. They do not take decisions; They merely implement central decisions. The center assigns the responsibility of providing certain public services and of implementing policies and programs to subordinate local levels under its supervision and control. Local participation is relied upon to ensure that public service provision responds to local needs.

An essential complement of the "de-concentrated" system in Vietnam is the "unified" budget. The annual budget approved by National Assembly includes revenues and expenditures of both central and local governments. All policy decisions relating to revenues and expenditures are taken at Peoples Committee at the National level and are implemented through the line agencies at central and local levels. The local administration in Vietnam consists of 61 provinces constituted by 598 districts, which in turn are made up of 8850 communes.

2. Fiscal Assignment

The budget law lays down the responsibilities of different agencies in budgeting. The Ministry of Finance (MOF) is responsible for estimating revenue forecasts and consolidating the recurrent expenditure estimates of all levels of government. MOF has to formulate the budget to match forecast of expenditures with revenues. The budget allocation is essentially a “top-down” process. The budget approved by the People’s Council is appropriated to the spending agencies and provincial governments. Expenditures are disbursed through the treasury. The MOF also undertakes financial inspection and audit of all organizations and units that receive government funds or contribute to it.

The Ministry of Planning and Investment (MPI) finalizes the investment budget of line ministries and local departments. The State Bank of Vietnam (SBV) helps the MOF in preparing the estimates of government borrowing to meet budgetary needs and advance money to cover temporary deficits in the State budget as decided by the Prime Minister. The line ministries and local departments prepare their recurrent and investment expenditure estimates based on the guidelines received and negotiate with the MOF in finalizing the estimates and allocate them to different branches and areas under their jurisdiction. They also monitor and implement the budgets of the branches under their charge. The Peoples’ Councils at local levels decide the draft budget of local governments and ratify their final accounts.

The Law defines expenditure responsibilities and revenue sources of different levels of government. Expenditures are assigned concurrently to central and local levels, but the assignment follows a functional separation based on the principle of geographical spread of benefits, size of the projects and volume of spending. In the case of revenues, the law specifies the taxes exclusively assigned to central and local levels and those that are shareable between them. The policy of determining the base and the rate structure is exercised by the Center. The customs department collects import-export taxes and the general taxation department (GTD), which is a central government agency, does the tax collection through its branches in provinces and districts. However, in respect of taxes assigned to them, local governments can retain entire collections in excess of the targets. Even in the case of taxes assigned to Central government, the provinces are given 50 per cent of the collections in excess of targeted revenues. This provides incentive to the provinces to help in better enforcement of tax collections.

Since 1998, local governments have been given powers to raise revenues from some fees, charges, tolls and voluntary contributions from the members of the community. Local governments do not have borrowing powers, but many local services like waste disposal, water and electricity supply and local transportation are entrusted to State Owned enterprises (SOEs). These can borrow funds from both internal and external sources after obtaining necessary permission from the Central government (these invariably involve sovereign guarantees).

3. Budget Formulation Process

In June every year, Government issues a decree for the preparation of the budget for the ensuing year. Based on the decree, the MOF issues a budget circular detailing the projected fiscal, macroeconomic and balance of payment environment and targets. The circular also

details the guidelines for the preparation of budget estimates for the ensuing year for each of the spending departments and provinces (and cities directly under the center). It also provides indicative targets of recurrent expenditure to each of the Central Ministries and Provinces.

The starting point in budget formulation for the spending agencies and local governments is the preparation of expenditure forecast. At each level, the spending departments prepare their expenditure estimates based on these guidelines and norms and submit them to the finance department at that level which, after consolidation are submitted to the respective People's Councils for approval. Simultaneously, the estimates are communicated to the finance department at the higher level. The process of preparing the budget extends all the way down to the commune level. The finance department at each level consolidates the draft budgets of spending agencies at that level as well as those below it. At the center, the MOF consolidates the estimates received from the line ministries and provinces.

MPI has been assigned the responsibility of formulating the investment budget. The total public investment is estimated by the MPI to be consistent with the envisaged growth rate of the economy and these are allocated to individual ministries and provinces. The line ministries and provinces are required to prioritize from among the approved projects to match the investment targets allocated to them. Investment projects are classified into three groups A, B and C depending on the nature and strategic importance of the projects and volume of investment. Group A projects have to be approved by the Prime Minister. He also decides projects under B and C, after it is duly approved by the MPI, if these projects have to be implemented by state owned enterprises (SOEs) or if they involve commercial borrowing after being approved by the MPI. The Ministers, heads of agencies in the ministries and, Peoples Committees of provinces and provincial cities can make the investment decisions pertaining to Group B and C projects.

The manner of allocating investment budget to central ministries and provinces is similar to that of recurrent expenditures. The resources available for investment after providing for recurrent expenditures are allocated among the provinces based on socio-economic conditions, level of development of the province, its population size, number of centrally managed projects in the province, and counterpart funding required for the ODA. Here again, system is predominantly "top-down". In effect, the line ministries and provinces should fit in their investment projects within the indicated targets. The provinces consolidate investment budgets of various provincial departments as well as those of governmental units below them and communicate them to the MPI. The MPI in turn consolidates the investment budgets of the provinces and the central government ministries.

The next step is to consolidate negotiated recurrent and investment expenditure estimates. Recurrent expenditure estimates and investment estimates made by the spending agencies are consolidated by the MOF and balanced with the estimates of revenue received by the GTD. Invariably, the expenditure estimates are higher by a large magnitude, the MOF cuts down the expenditure estimates of the line ministries and the provinces so that total expenditure matches with revenues, and borrowing is not used to meet current expenditures. In this process, the MOF determines the assignment of revenues to individual provinces and in case assigned revenues are inadequate, cash transfers are determined.

Estimation of expenditures is critical to determining the revenue assignment and cash transfers to provinces. Assignment of taxes is made such that in the aggregate, it covers most of the expenditure requirements of the provinces. Some taxes are entirely assigned to provinces

and some are shared with the center. Revenues from assigned taxes and shared taxes are projected in each of the provinces and are matched with expenditure requirements. The provinces which are left with gaps after tax assignment and sharing are given cash transfers.

The budget thus formulated is presented to the National Assembly for approval before the 30th November, and is passed before the end of the year. The MOF communicates the budget to the line ministries, provinces and the treasury for implementation. The finance departments at different levels supervise and control the implementation of the budget at the same level and the levels below them. They should ensure that the expenditures are incurred strictly according to the approved budget. The spending units prepare the spending plan and based thereon, the finance departments prepare the quarterly spending plans for each spending unit and the treasury ensures that the disbursements are made according to the plan.

Thus, although initial estimate of expenditures is made on the basis of norms, these are ultimately finalized by higher level of governments. The expenditure determination is thus, essentially a "top-down" process. This brings an element of opaqueness, raises scope for arbitrariness and subjectivity. However, once finalized, the assignment remains valid for three to five years with adjustment made to the estimates to take account of the effect of changes in economic conditions and prices and policy changes on revenues and expenditures.

III. *Trends in Fiscal Decentralization and Impact on Public Services*

1. **Trends in Expenditure Decentralization**

The role and functions of central and local governments in implementing expenditure programs have undergone changes. Expenditure decentralization as measured by the share of local administration in total expenditures has shown a steady increase from 26 per cent in 1992 to over 43 per cent in 1998. While this can partly be attributed to the more comprehensive coverage of local expenditures over the years, the general trend towards greater expenditure decentralization is unmistakable. Notably, increase in the share of local expenditures is seen even in the wake of decline in the ratio of government expenditure to GDP (excluding interest payments) from about 24 per cent in 1994 to 20 per cent in 1998.

Local governments implement 43 per cent of total expenditure programs in the country and, of this, about 4 percentage points are on account of National Programs. These are Central programs implemented through local governments using them as agencies. Thus, the expenditure falling within the discretion of local governments is just about 38 per cent. However, local role is important in human development. Almost three-quarters of education expenditures are incurred at local levels and in health expenditures, the local share is about two-thirds.

However, in reality, the power to influence expenditure decisions by local governments is much lower than that is indicated by these ratios. This is because: (i) inadequate assignment of resources in the wake of stagnancy in revenues makes it difficult to alter expenditure allocation between different functions and within each function between different economic categories; (ii) local governments have very little independent revenue raising powers and therefore, do not have the discretion to effect changes in the allocation; (iii) the problem is particularly severe for the provinces for which revenue assignment is inadequate to meet their expenditures and therefore, have to be given cash transfers.

2. Allocative and Technical Efficiency

(i) Subjectivity in Allocations

The method of finalizing expenditures is an important factor determining allocative and technical efficiency in the provision of public services. For formulating the budget, local governments estimate expenditure requirements on the basis of specified norms. In addition to financial allocation (budgetary) norms, there are physical norms and staffing norms stipulated by the relevant ministries. In the case of education, for example, there are as many as forty different norms which are applied in varying degrees by different local governments.

Existence of multiple norms is only a part of the problem. More important issue is the relevance of these norms. In most cases, population is taken as the principal factor, but allowances are also made for different terrain (plains, river delta or highlands and remote areas), perhaps to consider cost differences in providing public services. Additional cost disabilities in major cities is also considered.

The norms, howsoever appropriate, are used only to build the initial estimates. At best, these serve as guidelines and ultimately, expenditure is determined through the top-down process. The system is opaque and in this the relative bargaining strength of different provinces with the MOF does play some role. This system of determining expenditure allocation extends all the way to commune level. Provincial finance department allocates expenditures to the districts and the latter, to the communes.

In the ultimate analysis, the actual expenditures incurred by the provinces are distributed randomly and not related to any of the need factors (Table 1). For example, the regression estimates show that primary and secondary education expenditures are not related to the enrolment ratio or teacher-student ratio. It is not related to per capita GDP either. Expenditure on higher education is related only to enrolment ratio and not to per capita GDP or teacher-student ratio. The distribution of health expenditures among the provinces is even more difficult to explain. According to the norms the recurrent expenditures are supposed to

TABLE 1. REGRESSION EQUATIONS, 1998

Dep. variable	Constant	PGDP	Enrol. Ratio	Teacher-Student ratio	Hospital Bed/ Th. Persons	Medical Personnel per Th. persons	R Bar Sq	F - Statistics
PE	-3.3968 (-2.514)	0.2104 (1.087)	0.4421 (1.755)	-0.330 (-1.088)	—	—	0.0929	2.742
SE	-2.6935 (-2.665)	0.2283 (1.1395)	0.442 (1.938)	-0.1356 (0.543)	—	—	0.079	2.458
TG	3.2319 (6.452)	-0.1306 (-1.689)	0.726 (11.22)*	0.0404 (1.301)	—	—	0.8023	10.134*
HLT	8.434 (8.340)	0.667 (4.656)*	—	—	-0.054 (-0.331)	-0.561 (-3.56)*	0.435	13.591*

PE — Primary education expenditure per child in age group 5-9.

SE — Secondary education expenditure per child in the age group 10-14.

TG — Training (higher education) expenditures per capita.

* Significant at 1 per cent level. (The estimated regressions are in log-linear form.)

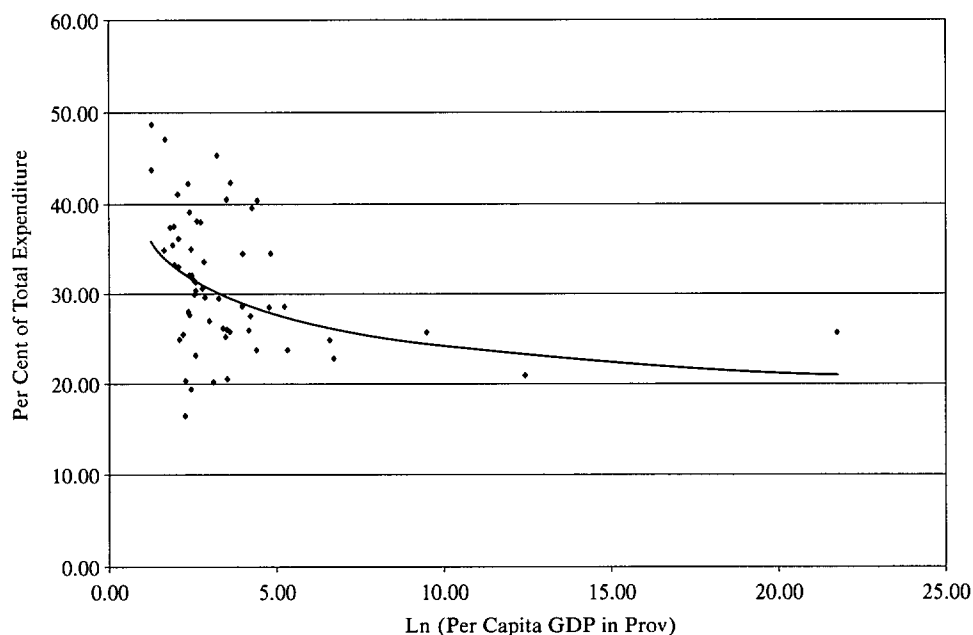
vary with the number of hospital beds. But, actual expenditures are related neither to hospital beds nor to the number of medical personnel. It is positively related only to per capita GDP. Thus, more affluent provinces have higher per capita expenditures.

(ii) Lack of Maneuverability

Lack of flexibility in altering allocations to various sectors and sub-sectors at local levels is another constraining factor in achieving efficient public expenditure allocation. The priority in local expenditure allocation to sectors and sub-sectors is determined at higher level. Within these, salary expenditure has the first call and it constitutes the bulk of expenditures. After meeting salary expenditures, there is very little left for other items, particularly in deficit provinces where expenditure allocation can not be altered due to lack of independent revenues. Thus, in the case of health expenditures, local governments can not provide medicines and equipment. In the case of education, after meeting teachers' salaries very little is left for books and teaching materials. Similarly, in the agricultural sector, the amount available for research and development is very little.

Figure 1 shows the share of salary expenditures in health expenditures in different provinces in 1998. It is seen that the share of salary expenditures shows an inverse relationship with the level of per capita GDP. Thus, more affluent provinces are able to add on resources from their own sources to provide a better mix of salary and non-salary components. This is true of all services. Thus, efficiency in expenditure implementation depends on the ability of local governments to generate additional resources and more affluent provinces can achieve greater efficiency in resource allocation due to their ability to generate larger independent revenues.

FIGURE 1. SHARE OF WAGES AND SALARIES IN PROVINCIAL HEALTH EXPENDITURE



Allocation of expenditures is supposed to take into account the regional preferences and priorities. However, the top down character that the system has does not provide much room to take account of variations in regional preferences. Thus, expenditure on primary health centers has continued even as their utilization rate has shown a decline.¹ Yet, rural population does not have access to primary medical care because there are no medicines available. When the need in remote areas is to outreach the households through mobile health personnel, the local governments can not change the delivery system according to their requirements. Similarly, even in provinces where there is considerable scope and advantage in utilizing water transportation, hardly any expenditure allocation is made and road transportation claims bulk of expenditures. The situation is similar in other services as well.

(iii) Inadequate Revenue Handles

A critical determinant of the quality of services provided at the local level is the ability of the local governments to mobilize own resources. In Vietnam, local governments have very little revenue raising powers. All decisions on tax rates and bases are decided by the Central government and all major natural resource revenues accrue to the center. The only independent source of revenue to the provinces is fees and charges they are empowered to determine revenues collected in excess of targets and voluntary contributions made by the community.

The lack of revenue powers to sub-national governments has important efficiency implications. First, it is felt by some provinces that in respect of taxes with immobile tax bases with a local spread, the center does not have adequate information on the tax bases and hence, revenue collections are much below the potential. In respect of these taxes, local governments have comparative advantage and central levy and collection not only enhances collection and compliance costs but also reduces revenue productivity. Second, in the absence of significant revenue handles, local governments have little leeway in determining resource allocation according to local preferences. In the absence of link between revenue and expenditure decisions, it has been difficult to impart a sense of ownership to local expenditure programs and this has caused both inefficiency and poor accountability.

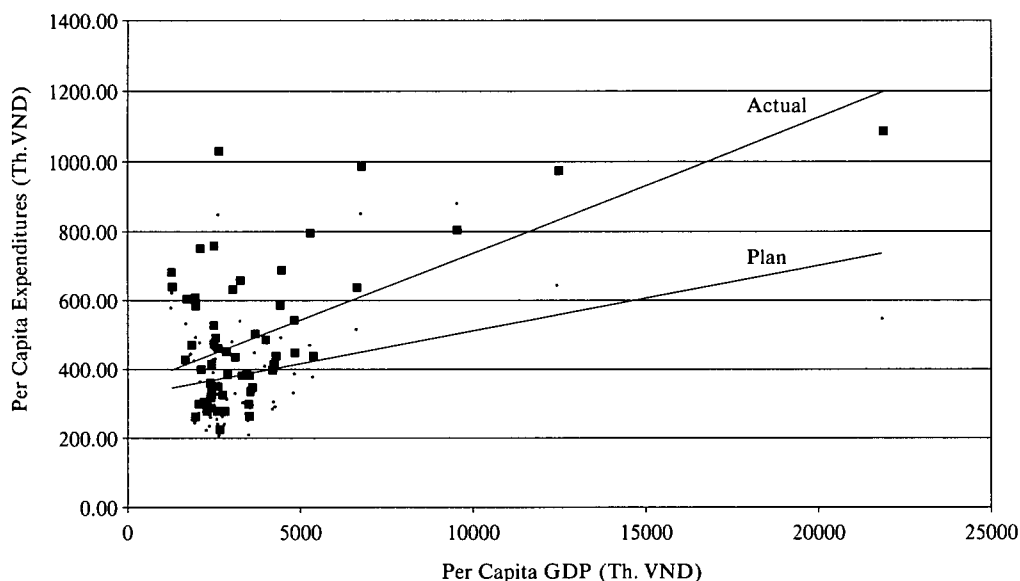
The assignment of power to impose some fees and charges to local governments since 1998 is a welcome step in providing them some independent revenues. Local governments can now determine school and hospital fees, market fees, tolls on roads under the jurisdiction of local administration. However, these constitute a very small proportion (less than 5 per cent) of total expenditures.

The main source of independent finance to provinces, however, is taxes actually collected in excess of the targets set in the budget. The provinces receive excess revenues not only from taxes assigned exclusively to them and from shared taxes, but also a portion of excess collections from exclusive central taxes. However, this provides an inherent incentive to underestimate revenues. Underestimation helps local governments gain additional independent revenues, the GTD can show that it has over-reached the targets and tax collectors get additional incentive payments.

Additional revenues collected by overreaching the targets can be spent on social sectors excluding spending on salary payments, on capital investment or maintenance or can be deposited in the Financial Reserve Fund. Thus, excess collections add to the provinces'

¹ Vietnam Health Sector Review, November 1999, (Draft).

FIGURE 2. EXPENDITURES IN PROVINCES-PLAN AND ACTUAL (1998)



maneuverability in expenditure allocation. All expenditure items, which the provinces find important, but unable to finance from the regular assignment, can be funded from excess revenue collections.

A comparison of projected with actual expenditures brings out the inherent incentive to underestimate revenues. In 1998 for example, in all provinces except Hanoi and Haiphong, actual expenditures were higher than the targets by varying magnitudes. In all provinces taken together, actual expenditure was higher than the budgeted by 27 per cent. Second, the difference between actual and budgeted expenditures has shown a steady increase since 1996 not only in the country as a whole but also in all the individual regions except in Red River Delta. Analysis shows that provinces with higher per capita GDP had higher percentage difference of actual expenditures over budget estimates (Figure 2). Thus, the system has provided the incentive for additional resource mobilization, but richer provinces have been able to take better advantage of this incentive.

Another important source of difference between assigned revenues and actual spending is community contributions. This can be an important source of financing public services at the level of communes and to a lesser extent, districts. Education and health sectors attract significant community contributions. Other sectors receiving contributions include rural roads and small irrigation works. In the case of education, for example, there are various types of fees. Parents are required to pay activity fee, there are construction fees or contribution for capital spending and fees for extra classes. Most contributions, in principle, are voluntary, but parents have little option but to pay them. There are also contributions in kind including labor for the construction of school buildings, health centers or rural roads.

As already mentioned, in the prevailing system of budgeting, with bulk of expenditures already earmarked for salaries, local governments can not wield much influence on expendi-

ture allocation. Their role gets marginalized further when the revenues show a downward trend. In such cases, the attempt is to push expenditure responsibility downward without changing revenue assignment. The lowest level of government is ultimately forced to raise community contributions to provide the minimum required services.

Inflexibility in expenditure allocation to local governments due to committed expenditure on salaries is a problem particularly faced at the commune level. Both employment and salary levels are decided at the higher level and in most cases, the expenditure allocation made is barely able to meet the salary cost of the commune health workers or teachers leaving very little for the medicines, equipment or teaching materials. In the event, there are wide variations in the standards of services provided depending on the ability of the communes to generate own resources through voluntary contributions.

Allocation of expenditures in the budgetary process is supposed to take into account the regional preferences and priorities. However, the top down character that the system has acquired over the years does not provide much room to take account of variations in regional preferences. Thus, the expenditure on primary health centers has continued even as their utilization rate has shown a decline.² Yet, rural population does not have access to primary medical care because there are no medicines available or when the need in remote areas is to outreach the households through mobile health personnel. However, the local governments can not change the delivery system according to their specific requirements.

3. National Programs

In addition to regular expenditures, local governments implement the National Programs. There are two types of National Programs. The programs with inter-sectoral scope and inter-locality spread and with clearly specified targets are called "National Target Programs". Schemes confined to individual sectors are classified as Sectoral Programs. At present there are seven National Target programs and 16 Sectoral Programs. Within each of them, there are a number of sub-programs covering both current and investment expenditures. The targeted national programs include Hunger Eradication and Poverty reduction (HEPR), Family Planning, Eradication of diseases and epidemics, Prevention of HIV, provision of clean drinking water, promotion of sports and creation of employment opportunities.

The main source of funding for the programs the State budget. In 1999, 3.7 per cent of the State budget was allocated to National Programs. In addition, some resources are made available from ODA assistance, which is predominantly in the form of loans. Another source of funding in recent years is by way of local contributions. To meet the specified targets, local authorities are required to mobilize resources to supplement budget allocation and ODA assistance. However, there is no stipulation that local authorities should spend from their own resources on the programs. The volume of local contribution depends on the decision of the Peoples' Committees in respective local authorities.

National Programs have served a useful purpose in ensuring minimum expenditure allocation in respect of important services. This is particularly true of services targeted to alleviate poverty, spread literacy and prevent and cure contagious diseases. The program has been especially helpful to disadvantaged groups in mountainous and remote areas. There is

² Vietnam Health Sector Review, November 1999, (Draft).

therefore, a case for strengthening the programs to enable equitable delivery of essential services.

IV. *Fiscal Arrangement and Inter-Regional Equity*

In the de-concentrated system the Center has complete control over the fiscal system to bring about the desired equalization. Inter-regional redistribution can be achieved either by the central government directly allocating expenditures to different regions or by determining the spread of expenditures incurred through local governments. It is difficult to trace the benefits of central government expenditures in different regions and therefore, most analyses of redistribution are limited to examining the distribution of provincial expenditures.

A measure of equalization is given by the difference in the pattern of distribution of revenue collections and assignments. Of course, it is not possible to definitively equate revenue collections with accruals in the respective provinces. This is because, many of the accounting offices/head offices are in major city centers and revenue collected in these centers is the result of the activities undertaken in many other regions. Besides, the possibility of inter-regional exporting of taxes makes it difficult to equate revenue collections with accruals. Nevertheless, difference in the pattern of distribution can be taken to indicate a broad direction in equalization.

The distribution of revenue collections and assignments in different regions in Vietnam shows that despite the weaknesses of the system mentioned above, a substantial portion of the revenues collected in richer provinces is redistributed to poorer provinces for spending. Analysis shows that in 1998, while the revenue collections were appreciably higher in more affluent provinces, the revenues ultimately assigned them were significantly lower than their collections and vice versa. Thus, when per capita GDP in provinces was higher by one per cent, revenue collections were higher by 1.8 per cent, but they were assigned only 0.9 per cent of extra revenues (Table 2). The difference between the revenue collection and assignment represents revenue equalization. It is seen that degree of revenue equalization has remained broadly the same right from 1996.

The issue however, is whether this order of equalization is adequate to offset revenue and cost disabilities of poorer provinces. First, what is measured above is simply the degree of equalization of revenues. It does not consider variations in cost factors affecting the public services in different provinces. Thus, standards of services could vary from one province to another even if revenue assignment is identical. To ensure equalization of public services, it is necessary to design the system to take into account cost variations as well.

Analysis of per capita expenditures in 1998 brings out that revenue equalization achieved in Vietnam is inadequate to offset the fiscal disabilities of provinces. It is seen that per capita expenditures in high-income provinces are significantly higher than in middle and low-income provinces (Table 3). In the three highest income provinces (Hanoi, Ho Chi Minh and Ba Ria-Vung Tau) per capita aggregate expenditure was twice that of the average of the country and 2.4 times that of middle and low-income provinces. Similar pattern of distribution of expenditures is seen in the case of education, health and transport. There is a significant difference in per capita expenditures in the three provinces and other high income provinces on the one hand and the latter and middle and low-income provinces on the other. The

TABLE 2. INCOME ELASTICITY OF REVENUES AND EXPENDITURES

Revenue/Expenditure	Constant	Elasticity	R bar Sq
1. Current Expenditure			
1996	4.2584	0.1652	0.0330
1997	4.3662	0.1582	0.0454
1998	3.6033	0.2714**	0.1343
1999	5.0900	0.0680	0.0063
2. Capital Expenditure			
1996	0.3138	0.5987*	0.2332
1997	0.4101	0.5244*	0.1504
1998	0.9152	0.4826*	0.1579
1999	1.2434	0.4227*	0.2135
3. Total Expenditure			
1996	3.3992	0.3113*	0.1345
1997	3.7798	0.2731*	0.1244
1998	3.4991	0.3256*	0.1639
1999	4.6026	0.1693	0.0493
4. Revenue Collection			
1996	9.2134	1.9029*	0.8223
1997	9.2138	1.8813*	0.8215
1998	8.5532	1.7806*	0.7573
1999	11.3135	2.0871*	0.7670
5. Revenue Assignment			
1996	-3.1871	1.0746*	0.6820
1997	-3.2393	1.0903*	0.6661
1998	-2.0184	0.9330*	0.5581
1999	3.7422	1.0845*	0.6487

Note: * Significant at 1 per cent level ** Significant at 5 percent level

TABLE 3. LOCAL EXPENDITURES ON DIFFERENT SERVICES, 1998

	Education	Health	Agriculture	Transport	Total
1. Per Cent of GDP					
Hanoi, Ho Chi Minh and Ba Ria - Vung Tau	1.4	0.8	0.2	0.7	9.3
Other High Income Provinces	2.8	1.0	0.3	1.1	13.5
Middle Income Provinces	3.6	1.2	0.3	1.2	13.0
Low Income Provinces	5.2	1.4	0.2	1.3	16.8
Vietnam	3.0	1.1	0.3	1.0	11.3
2. Per Capita (Th. VND)					
Hanoi, Ho Chi Minh and Ba Ria - Vung Tau	177	98	20	86	934
High Income	120	43	32	46	464
Middle Income	105	35	26	35	383
Low Income	118	32	24	29	382
Vietnam	122	43	26	41	460

Source: Ministry of Economy and Finance.

expenditure levels in middle and low-income provinces, however, are not different.

The pattern of expenditure spread among provinces in 1998 shows that per capita expenditure are significantly higher in provinces with per capita GDP as shown in Table 2. It is seen that per capita expenditures were higher by 0.3 per cent for every one per cent higher per capita GDP. Further, planned expenditures were distributed more equally among the

provinces as compared to actuals. In 1998 for example, planned expenditure were higher in provinces with higher GDP only marginally — it was higher by only 0.17 per cent for every one per cent higher GDP. Thus, while formulating the budget, the intention is to achieve substantial equalization I expenditures, in actual practice, this could not be achieved for the reasons described earlier. It is also seen that provinces with higher per capita GDP had significantly higher per capita capital expenditures even more than current expenditures. This feature is seen in all the years since 1996 and it points towards increasing regional inequality in the provision of physical infrastructure.

The reasons for the distribution of per capita expenditures in favor of relatively more developed provinces is not difficult to see. The indicative norms used to make initial estimates of expenditure are mainly population based. In some cases they actually favor the states with better infrastructure. Even these norms play only an indirect role for, in the final analysis, expenditures are adjusted to match revenues.

Thus, the process does not ensure adequate mechanism to offset revenue and cost disabilities. In addition, giving excess collections over the targets as an incentive tends to favor better off provinces. Fees and charges as well as voluntary contributions too ensure a better allocation to the richer provinces. Thus, in order to generate comparable levels of services, poorer localities (particularly at communes) choose to collect higher “voluntary payments” and that makes the system regressive.

V. *Concluding Remarks*

Sustaining economic growth in Vietnam in the medium and longer term context will depend upon, inter alia, the ability of the government to evolve conducive institutional framework including fiscal and administrative structures for delivering equitable and efficient levels of public services. Further, as the economy makes transition to the market economy, demand for evolving a rational system of intergovernmental relationships to provide accommodating levels public services to varied preferences and requirements of different regions will increase. The recent reform measures introduced by the government reflect the importance it attaches to the issue of providing a proper institutional framework for delivering public services. However, as the foregoing discussion shows, there are still some serious shortcomings and potential perverse incentives requiring reform.

Although the system of fiscal assignments in the budget law provides incentive to local governments for resource mobilization, it has two specific problems. First, the system has the potential of creating serious distortions. At present, the tax officials are accountable to both central and local governments and the incentives given to tax officials to collect more revenues from the taxes assigned to them can cause distortions in the tax structure. Second, the assignment is essentially origin based and the provinces can retain revenues in excess of the targeted collections. This tends to relatively disadvantage the local governments with smaller revenue bases.

Balancing incentives with equity is one of the difficult challenges in fiscal assignment. One possible way to resolve the issue in Vietnam in the medium term is to assign some tax bases (as against tax revenues) to local governments. The power to determine the base and rate structure of locally based taxes and in respect of which the local governments have an

advantage in collection could be clearly assigned to local governments whereas, all broad-based taxes could vest with the center. The local governments could have their own small tax departments to administer their taxes, independent of the central taxation department. The local governments would also receive a share in total revenues collected by the center, which can be fixed for a period of three to five years. The shares to the provinces can be determined not on the basis of origin, but on the basis of a formula representing shortfall in capacity to achieve the required measure of equalization. The cost disabilities for the mountainous provinces can also be taken into account in the equalization formula. Assigning tax powers to the local governments would impart flexibility and incentives to their budgetary decisions and at the same time, retaining power to levy broad based taxes at the center would enable it to undertake stabilization and regional redistribution measures effectively.

An important shortcoming in the fiscal arrangements is the system of determining expenditure and revenue allocations through negotiations. It is important to move over to a formula based system in the medium term to allocate resources according to the requirement of different regions and localities and to impart fairness and objectivity to the system. Tax sharing and cash transfers would have to be designed to offset revenue and cost disabilities of poorer localities. At the same time, it is necessary to ensure that the transfer formula is kept simple. Developing a reliable information system and systematic compilation of not only revenue and expenditure data but also of important economic indicators like GDP, its sectoral composition, demographic structure of population at both national and provincial levels is critical to evolving a formula based transfer system.

Keeping the tax assignment unchanged for 3 to 5 years in the budget law imparts a degree of certainty and helps the local governments to plan their activities. However, the arrangement places the poorer provinces getting cash transfers at a disadvantage unless it is indexed fully to neutralize increase in prices.

Assigning the right to levy some charges and fees to the provinces has provided them some flexibility in budget implementation though, the revenue from their own sources is less than 5 per cent. However, in the absence of other independent revenue sources, local governments have had to make intensive use of these instruments and this has resulted in wide inter-provincial variations.

Reforms in intergovernmental fiscal arrangements to enable efficient delivery of public services to accommodate the requirements of a market economy will have to proceed in terms of devolving greater powers to sub-national governments. In particular, it is necessary to empower the local governments with some revenue handles. This will provide them with greater flexibility in expenditure decisions and will ensure allocative and technical efficiency in the delivery of public services. Such an arrangement will also ensure greater accountability and incentives by linking revenue raising and expenditure decisions. This, however, has to be accompanied by concerted attempt at capacity building of local governments. In the initial stages, greater decentralization in revenue decisions could be attempted in respect of provincial cities such as Ha Noi, Ho Chi Minh, Da Nang and Hai Phong where the capacity to administer the taxes is already high, and later extended to other provinces as the capacity develops.

Another important area where reforms are necessary is in respect of designing an intergovernmental transfer system, which is simple, transparent and equitable. It is necessary to replace the prevailing negotiated system with formula based system and the formula should be designed to offset revenue and cost disabilities. This is an important area and Vietnam can

well learn from the experience of a number of countries in designing an appropriate transfer system, which will fulfil the objectives of intergovernmental transfers without involving disincentives on fiscal management.

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